British Columbia Ferries Commissioner

Annual Report

for the Fiscal Year Ending
March 31, 2015

Prepared and submitted in accordance with
Section 53 of the Coastal Ferry Act
of the Province of British Columbia

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BRITISH COLUMBIA FERRIES COMMISSIONER

To the Lieutenant Governor in Council

Victoria, BC
August 27, 2015

May It Please Your Honour:

BC Ferries Commissioner Annual Report
For the Fiscal Year Ending March 31, 2015

I am pleased to submit to you the twelfth Annual Report of the BC Ferries Commissioner.

As required by section 53 of the *Coastal Ferry Act*, the Report sets out briefly all applications and requests for decisions to the Commissioner under the Act, all orders issued by the Commissioner, the financial statements applicable to the Office of the Commissioner for the above period along with full disclosure of the expenses of, and associated with, the Office of the Commissioner.

Yours truly,

Gord Macatee
BC Ferries Commissioner

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Introduction

The Office of the BC Ferries Commissioner regulates ferry operators under the *Coastal Ferry Act* of 2003 as amended by subsequent legislation (the "Act"). The Province appoints the commissioner and up to two deputy commissioners for a term of at least six and not more than eight years. They are independent of both the government and the ferry operators. Gord Macatee of Victoria BC was appointed commissioner on May 1, 2011 for a six-year term expiring on April 30, 2017. Sheldon Stoilen of Bowen Island was reappointed deputy commissioner for a six year term expiring on June 30, 2020.

The role of the commissioner is set out in section 38(1) of the Act which stipulates the commissioner must regulate ferry operators in accordance with the following principles:

a) the primary role of the commissioner is to balance, in the manner the commissioner considers appropriate, the interests of ferry users, taxpayers and the financial sustainability of ferry operators;

b) ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;

c) ferry operators are to be encouraged to seek additional or alternative service providers on designated ferry routes through fair and open competitive processes; and

d) ferry operators are to be encouraged to be innovative and to minimize expenses without adversely affecting their safe compliance with core ferry services.

This is the twelfth annual report of the commissioner and has been prepared in accordance with Section 53 of the Act. The report summarizes all major decisions, orders and reports issued by the commissioner and the financial statements of the Office of the BC Ferries Commissioner for the fiscal year ended March 31, 2015 ("FY 2015"). The report includes the commissioners' opinions on the performance of British Columbia Ferry Services Inc. ("BC Ferries") relative to its obligations under the Act and the Coastal Ferry Services Contract. The report also includes the commissioners' opinion regarding the performance of the BC Ferry Authority relative to its obligations under the Act.

Decisions, Orders and Reports of the Commissioners in 2015

The following sets out briefly all applications and requests for decisions to the commissioners under the Act and the orders and reports of the commissioners during FY 2015:

Order 14-02 – September 29, 2014

This Order responded to BC Ferries' request for a decision regarding its submission of a 10 year Capital Plan. The commissioners confirmed that BC Ferries had complied with section 64.1 of the Act and approved the 10 Year Capital Plan for publication under section 40 of the Act.

Order 14-03 – November 24, 2014

This Order approved BC Ferries' application under s. 55(2) of the Act for a proposed major capital expenditure for the Mid-Life Upgrades for the two Spirit Class vessels, as generally described in the Application, subject to the following conditions:

a) The maximum amount of the major capital expenditure for the Mid-Life Upgrades to the Spirit Class vessels is set at the total amount for all work packages combined as stated in the Application which will be confirmed by a separate confidential order to BC Ferries. The maximum amount will remain confidential until completion of the procurement process;

b) Prior to signing a final contract with a shipyard for Mid-Life Upgrades, BC Ferries must:

(i) satisfy the commissioners that the scope of Mid-Life Upgrades is as generally described in the Application and the total cost of all the work packages combined does not exceed the maximum amount approved by the confidential order referred to in paragraph (a) above;

(ii) confirm that there has been no substantial change to the scope of any of the work packages and that the business rationale justifying each work package has not substantially changed in terms of net present value and payback periods;

(iii) satisfy the commissioners that the company has a contingency plan which addresses the concerns of commercial ferry users in the event of a potential delay in the re-entry of service of the vessels.

Order 15-01 – February 2, 2015

This Order approved BC Ferries' application under s. 55(2) of the Act for a proposed major capital expenditure for the Fare Flexibility and Digital Experience Initiative, subject to the following conditions:

a) The maximum amount of the major capital expenditure for the Initiative is set at the total amount as stated in the Application which will be confirmed by a separate confidential order to BC Ferries. The maximum amount will remain confidential until substantial achievement of all milestones identified in the project plan for the Initiative;

b) All future life cycle capital costs for the Initiative which enable continued functionality of the Initiative or sustainment of the benefits from the Initiative will be subject to the commissioners' further approval;

c) BC Ferries may commence the procurement process for the Initiative, but must not enter into a binding agreement until it satisfies the commissioners that issues identified in the performance review of the parallel Automated Customer Experience ("ACE") program, as they relate to the Initiative, have been addressed and that an appropriate, integrated IT program management process is in place;

d) If BC Ferries is authorized to proceed with implementation of the Initiative pursuant to subparagraph (c) above, it may do so only on the routes 1, 2, 3, 30, 9, 10, 11 and 17 (the "Reservable Routes"). If BC Ferries decides at some future date that it wishes to proceed with implementation of the Initiative beyond the Reservable Routes, it must satisfy the commissioners that a comprehensive public information and consultation process has been undertaken and that the concerns of ferry users on the relevant routes have been considered.

Order 15-02 Preliminary Price Cap Decision – March 18, 2015

This Order sets the preliminary price cap increase on ferry fares at 1.9% each year over the upcoming four year performance term, beginning April 1, 2016, and ending March 31, 2020.

The preliminary decision was based on the commissioners' assessment of information provided by BC Ferries, which included:

- a summary of financial and operating results for the current performance term 3 (PT3);
- a cost projection for the upcoming performance term 4 (PT4);
- a 12 year capital plan; and
- an efficiency plan and additional supporting information.

The commissioners also reviewed comments provided by the public in response to BC Ferries' PT4 submission.

The commissioners' Report on the Preliminary Price Cap Decision for the Fourth Performance Term provides a review of the current performance term. Progress made by BC Ferries during PT3 includes the following:

- positioned to exceed the PT3 efficiency target of $54 million;
- lowered administrative costs by $5 million since 2009;
- reduced executive compensation levels by $1.2 million per year;
- reduced overtime costs;
- implemented safety improvements leading to reductions in WorkSafeBC premiums;
- achieved positive labour relations, with no disruptions for more than 12 years;
- initiated capital projects on time and on budget;
- commenced development of new technology systems to support flexible pricing and expanded reservation systems; and
- achieved continued growth of ancillary revenues, resulting in revenue that has relieved pressure on fares.

As part of its preliminary price cap decision, the commissioners are calling on BC Ferries to make further productivity improvements of $27.6 million by the end of PT4.

The public was invited to comment on the preliminary price cap decision and accompanying report by June 30, 2015. The commissioners must make a final decision on the price caps for PT4 by September 30, 2015.

Performance Reviews Conducted in FY 2015

As part of the preliminary price cap review process the commissioners engaged the consulting firm of PricewaterhouseCoopers ("PwC") to conduct the following performance reviews on BC Ferries' which were published on March 18, 2015:

a) Performance Review of the Efficiency of BC Ferries;

The significant findings were as follows:

- BC Ferries is demonstrating good cost control, especially in the area of Administrative expenses. Overall Administrative expenses have been reduced as a result of lower executive compensation and reduced head count. Lower scheduled and unscheduled overtime hours have also assisted in moderating overall labour cost increases.

- Cost control has been achieved while obtaining good outcomes with customer satisfaction and passenger and employee safety.

- The assessment of financial and management controls and processes addressed planning, budgeting, reporting and internal controls has been conducted at a high level. The assessment determined that these controls and processes appear to be appropriate.

- BC Ferries appears to have a strong culture of efficiency, based on its sound budgeting process, and alignment of performance pay with corporate objectives.

- BC Ferries' executive compensation compares favourably against that of several provincial Crown Corporations. BC Ferries' executive compensation policies and procedures appear appropriate for an organization of its size and complexity.

- BC Ferries complies with the Public Sector Employers' Council guidelines for at-risk compensation, organizational layers and direct reports to the CEO. The number of managers do not appear to be excessive.

b) Performance Review of BC Ferries' Fuel Management

The significant findings were as follows:

- BC Ferries' efforts to manage and minimize consumption of fuel have been effective.
- BC Ferries have defined procedures in place to manage consumption and costs and are compliant with these policies and procedures.
- The current deferral account mechanism in place that acts as a hedge against fuel price volatility is considered appropriate.

The following issue was identified for consideration by the commissioners:

- BC Ferries has adopted the policy of locking into fixed price swaps when pricing is available at or below the indicative set price. There is no strong evidence that suggests that the indicative set price is the optimal point to hedge fuel costs. Although the decisions to lock into fixed price contracts at or below the indicative set price are being driven to avoid fuel surcharges and provide fare certainty for periods of time, the strategy does not necessarily result in the best value for fare payers. As a policy that is in the interest of users, fuel hedging may be used to limit increases in fares to the rate of inflation.

c) Performance Review of BC Ferries' Homeporting Arrangements

Significant conclusions were as follows:

- There are no major concerns regarding the rationale or efficiency of current arrangements. Many of the Company's current Points of Assembly have been in place for several decades and would be cost-prohibitive to change. Existing homeports are reasonable and should only be reconsidered when any major capital, service or labour decision is made for the route.
- With respect to future homeporting decisions no formal policy exists around homeporting decision making. It was suggested that a homeporting policy be established for new routes which provides guidelines to homeporting considerations when major decisions are made on existing routes. Also crew accommodation should be a consideration on any new vessel procurements for the minor and northern routes to provide future flexibility in homeporting.

d) Performance Review of BC Ferries Vacations

The significant conclusions were as follows:

- BC Ferries Vacations ("BCFV") is meeting its intended goals. The business case for the service appears to be relatively strong given the consumer takeup since inception and the high level of participation by partners.
- BCFV gross and net revenue expectations have exceeded the initial targets set out in the original five-year business plan. BCFV has achieved a 151 percent growth in revenues in the last four years, while expenses have declined 45 percent from the first year.
- The contribution and costs of a centrally located service centre in downtown Vancouver relative to another central location in either Vancouver or Victoria do not appear unreasonable. The benefits and costs of locating the Vacations Centre in its current downtown location are difficult to assess, as the store-front location contributes to general marketing and many information requests lead to follow-on sales, some of which become part of general tariff and reservation revenues. While a greater takeup of the Vacations Centre services is by Lower Mainland residents than by out-of-province visitors, direct costs for labour and store front space of the downtown Vancouver location appear reasonable.
- Revenue and cost information for the BCFV are part of BC Ferries' annual budgeting process. From a reporting structure, BCFV is part of Travel Services within the Corporate Development department. The head of the service reports to the VP of Marketing and Travel Services. This reporting structure

appears appropriate given the complementary activities within Corporate Services that includes Web services and branding activities.

- An extensive list of active partners that includes over 80 hotels has been developed. These partners have been receptive to participation in packaged tours in Northern and Southern routes, suggesting that widespread incremental economic benefits are being generated in coastal communities as a result of the services. BC Ferries' investment in tourism marketing programs is also building demand in communities that have limited marketing resources.

- Discounts offered on fares and hotels are consistent with industry practice. BCFV discount policies are the same as those offered other tour operators and BC Ferries do not offer discounts in excess of their best tour operator customers.

- BCFV has yet to reach a mature state. It has the potential to expand further with self-serve options as the new on-line reservation system is further developed.

BC Ferries and BC Ferry Authority Performance in 2015

During FY 2015 the commissioners continued their practice of conducting quarterly meetings with BC Ferries to review their quarterly reports on price cap compliance, operations summary, customer complaints resolution, and deferral account balances. The commissioners also reviewed and posted on their website BC Ferries' Annual Report to the Commissioners for FY 2015 which was submitted as required before July 31, 2015. The commissioners received satisfactory responses from BC Ferries to all follow-up queries and requests for additional information.

The key findings of the commissioners for the year ended March 31, 2015 are that BC Ferries:

- complied with price cap increase of 4.0% for all routes combined;

- delivered a total of 77,432.5 round trips or 683.5 more than the 76,749.0 round trips required under the Coastal Ferry Services Contract ("CFSC"). Many of these additional round trips were delivered in the summer on route 21 (Buckley Bay to Denman Island) and route 22 (Denman Island to Hornby Island) to accommodate peak period traffic demand. There were 104 required round trips cancelled for weather or other reasons allowed under the CFSC;

- maintained good on-time performance of 91.7% system wide and a high standard of service reliability delivering 99.75% of the scheduled sailings;

- provided capacity to carry the traffic with capacity utilization on the designated routes ranging from 27.9% to 73.2% with vehicle and passenger traffic increasing by .6% and .5% respectively compared to year ended March 31, 2014;

- increased annual capacity utilization by 2% system wide and 5.7% on routes with service level adjustments;

- conducted the annual customer satisfaction survey indicating 85% of passengers in 2014 reported to be satisfied overall with their experience travelling on BC Ferries. This percentage is a slight decrease from 2013 (87% satisfied). Overall satisfaction with overall money value of fares declined with 45% of customers dissatisfied in 2014 compared to 39% dissatisfied in 2013. BC Ferries' comments and action plans addressing the results of the 2014 survey are outlined in their Annual Report to the BC Ferries Commissioner for the year ended March 31, 2015 which can be found on the commissioners' website;

- responded reasonably to ferry users input by adjusting some of the service level adjustments mandated by the Province upon completion of community consultations; and

- is on pace to exceed efficiency targets and savings from service level adjustments incorporated in the price caps for the current performance term.

Based on our reviews and key findings, the commissioners are satisfied that during FY 2015, BC Ferries met its obligations under the *Coastal Ferry Act* and also met its obligations under the Coastal Ferry Services Contract.

Finally, based upon a review of BC Ferry Authority's submission to the commissioners and discussion with the Chair of its Board of Directors, the commissioners are satisfied that the BC Ferry Authority performed all of its obligations under the Act during FY 2015.

Gord Macatee
BC Ferries Commissioner

Sheldon Stoilen
Deputy BC Ferries Commissioner

Price Cap Compliance

The chart below tracks the values of the price cap index compared to an index of actual weighted average fares system wide for BC Ferries (price cap index was reset at 100 effective the beginning of the third performance term on April 1, 2012).

The values for the indices are computed by methods laid down in Commission Order 05-01 and Order 11-03 and are based on trailing four-quarter data. The commissioners allows BC Ferries to exceed the price cap (highlighted in colored or shaded text) for no more than three consecutive quarters. This ensures that the company does not retain revenues earned at above-price cap levels.

The chart shows that BC Ferries did not exceed the price cap for more than three quarters during FY 2015. Accordingly, the company was in compliance with the price cap during the year.

BCFerries

Average Fare Index Summary

		PT3						
		Sep-2013	Dec-2013	Mar-2014	Jun-2014	Sep-2014	Dec-2014	Mar-2015
System								
	Cap	106.68	107.60	108.42	109.54	111.08	111.97	112.76
	Actual	107.16	108.06	108.42	109.39	110.74	111.89	112.76

- Price cap and price compliance indices are calculated in accordance with Commission orders 05-01 and 11-03.

-The annual price cap increase for each fiscal year is phased in over four quarters. The amount phased in will vary from quarter to quarter as it is based on proportions of revenue received in the previous year for that quarter. The amount of the phase in for a particular quarter can vary from year to year due to variations in prior year revenue. Such variations can be caused, for example, by the timing of promotions and changes in the timing of Easter. (Easter occurs in either Quarter 1 or Quarter 4)

-As per BCFC Memorandum 45, BC Ferries has transferred the revenue earned in excess of the price cap to a fuel deferral account, and as a result the Actual index is equal to the Price Cap as at March 31, 2014

Activity Summary

Commissioner Activities in FY 2015

1. **Regulation of Ferry Fares and Service Levels**
   - monitored BC Ferries compliance with the price cap and delivery of contracted round-trips under the CFSC
2. **Special Decisions**
   - approved a major capital expenditure for the Mid-Life Upgrades to the Spirit Class Vessels
   - approved a major capital expenditure for the Fare Flexibility and Digital Experience Initiative
   - approved the submission of BC Ferries' 10 year Capital Plan for purposes of publication and invited comments thereon
   - released the Preliminary Price Cap Decision allowing price cap increases of 1.9% for each year of the next performance term starting on April 1, 2016
3. **Enforcement and Performance Reviews**
   - conducted four performance reviews on BC Ferries' efficiency, fuel management, homeporting and BC Ferries Vacations
4. **Administration and Reporting, Publication, Outreach**
   - maintained records; submitted Annual Report and Service Plan; published decisions and communicated with stakeholders

The commissioners' activities during FY 2015 are summarized in the table to the left. The core ongoing activities are regulating ferry fares through the price cap mechanism, and monitoring compliance with service levels specified in the Coastal Ferry Services Contract.

Special decisions in FY 2015 included the Preliminary Price Cap Decision for the next performance term as well as decisions relative to the approval of major capital expenditures of which there were two applications under s.55(2) during the year. Special decisions also include consideration of opportunities for possible alternate service providers or the regulation of unfair competitive advantage. There was no activity in these areas during the year other than monitoring compliance with regard to Order 11-01 in respect to drop trailer operations.

There was also no activity in FY 2015 for Enforcement as BC Ferries was found to be compliance with its obligations under the *Coastal Ferry Act* and the Coastal Ferry Services Contract.

During the year the commissioners conducted four performance reviews on BC Ferries' efficiency, fuel management, homeporting and BC Ferries Vacations. Reports for each performance review which summarized the significant findings and conclusions were published together with the preliminary price cap decision on March 18, 2015.

An important activity area for the commission is keeping the public informed about the commissioners' role, activities and decisions. The commissioners invited public comments on the two proposed major capital expenditures. The public was also invited to comment on BC Ferries' submission for the next performance term, their Efficiency plan and their 10 Year Capital Plan as well as all regulatory reports submitted to the commissioner which are all published on the commissioners' website.

Financial Statements

Accounting Services

The Ministry of Justice provides accounting and payment services at no cost to the commission. The summary financial statement is based upon information provided by the ministry.

Summary Financial Statement

BC Ferry Commission
Summary Financial Statement
(Expenditures in $ thousands)

	FY 2015 Budget	FY 2015 Actual	FY 2014 Actual
Commissioners' Fees and Expenses	281	212	192
Professional Services	482	439	271
Other Expenses	32	44	26
	795	**695**	**489**

Budgeted Expenditures

The *Coastal Ferry Act* requires ferry operators to cover the expenses associated with the operation of the Office of the BC Ferries Commissioner. Under section 59(2) of the Act the budget for the Office of the BC Ferries Commissioner must not exceed 1/5 of 1% of the ferry operator's previous year's tariff revenue. Total budgeted expenditures for FY 2015 were $795,000 or 85% of the maximum budget allowable under Act.

Actual Expenditures

Actual expenditures in FY 2015 were $695,000, or 87% of the budget. Expenditures were for commissioners' fees and expenses, fees and expenses for consultants' professional services and other expenses.

Commissioners' Remuneration

The commissioner and deputy commissioner are paid a per-diem fee for their services. The commissioner received $74,250 in fees for his services and was reimbursed $3,244 for travel and other expenses. The deputy commissioner received $120,300 in fees for his services and was reimbursed $14,669 for travel and other expenses incurred in the period.